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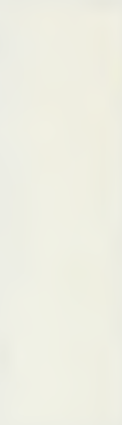
Review of Travelex America, Inc.,
Foreign Currency Exchange
Operations at the San Francisco
International Airport



Audit Division
Audit Number 02022
July 21, 2003

PLATE 10 (REV.)

10-10-10





CITY AND COUNTY OF SAN FRANCISCO

**OFFICE OF THE CONTROLLER
AUDITS DIVISION**

**Ed Harrington
Controller**

**Monique Zmuda
Deputy Controller**

July 21, 2003

Audit Number 02022

San Francisco Airport Commission
P. O. Box 8097
San Francisco International Airport
San Francisco, CA 94128

President and Members:

The Office of the Controller presents its report concerning the audit of Travelex America, Inc. (Travelex). Travelex has a lease with the Airport Commission of the City and County of San Francisco that gives Travelex the exclusive right to provide foreign currency exchange services at the San Francisco International Airport (SFO). For each foreign currency exchanged by Travelex, the lease specifies the maximum spread or the difference that Travelex can charge its customers at SFO from the exchange rate posted by the New York Federal Reserve Bank.

Travelex is required to annually report its gross revenues to the Airport Department (Airport). The Airport requested that we conduct this audit to verify whether Travelex correctly reported gross revenues and whether Travelex charged the permissible exchange rate specified in the lease on foreign currency exchange transactions at SFO. Our audit period was from July 1, 2001, through June 30, 2002.

Travelex, in all material respects, correctly reported foreign exchange gross revenues of \$29,534,058. However, Travelex charged exchange rates in excess of the allowed rates for most of the foreign exchange transactions we tested in six sample days. Because of Travelex's substantial non-compliance with lease terms, the Airport Director may impose a fine of \$500 per day that Travelex charged excessive exchange rates and may charge Travelex approximately \$19,000 for the cost of this audit.

The response of Travelex is attached to this report. The Controller's Audits Division will be working with the Airport to follow up on the status of the recommendations made in the report.

Respectfully submitted,

Noriaki Hirasuna
Director



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INTRODUCTION

BACKGROUND

Travellex America, Inc., (Travellex) has a five-year lease with the Airport Commission (commission) of the City and County of San Francisco (City) to operate foreign currency exchange services, on an exclusive basis, in ten locations at the San Francisco International Airport (SFO). The rent commencement date was December 10, 2000, which established the initial lease year. Subsequent lease years began on January 1 of each year. Travellex pays rent based on the greater of a minimum annual guarantee or a fee equal to 88 cents for each passenger boarding international flights during the lease year.

The lease requires Travellex to submit to the Airport Department (Airport) an annual report showing Travellex's gross revenues by service rendered. While Travellex did not submit an annual report for 2001 and 2002, Travellex submitted two sales reports covering the period from August 2000, through July 2002. Travellex included in its sales reports the gross profit it earned on foreign exchange transactions even though the lease does not require this information.

The lease specifies the spread, which establishes the maximum exchange rates at which Travellex is allowed to buy and sell foreign currencies from customers at SFO. The maximum exchange rate of a foreign currency exchange transaction is the specified percentage spread plus the exchange rate posted for the foreign currency by the New York Federal Reserve Bank as published in the San Francisco Chronicle.

SCOPE AND METHODOLOGY

The purpose of this audit was to determine if Travellex correctly reported its foreign exchange gross revenues in compliance with the reporting provisions of the lease. We also determined whether Travellex complied with the provisions of its lease regarding the maximum exchange rates that Travellex is allowed to charge on foreign currency exchange transactions. At the request of the Airport, we also determined whether Travellex accurately reported its foreign exchange gross profits. The audit period was from July 1, 2001, through June 30, 2002.

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To conduct the audit, we reviewed the applicable terms of the lease and the adequacy of Travelex's procedures for recording, summarizing, and reporting its gross revenues to the Airport. To determine whether Travelex accurately reported its gross revenues and gross profits on its foreign exchange transactions, we tested on a sample basis Travelex's monthly sales summaries, daily sales reports, and cash register summary reports. To determine whether Travelex charged the allowable exchange rates, we tested on a sample basis some foreign-currency exchange transactions.



AUDIT RESULTS

TRAVELEX CORRECTLY REPORTED ITS GROSS REVENUES

From July 1, 2001, through June 30, 2002, Travelex America, Inc., (Travelex), in all material respects, correctly reported gross revenues of \$29,534,058 to the Airport. Although Travelex is not required by its lease to report gross profits, at the Airport's request we determined that the gross profits of \$3,690,743 that Travelex reported to the Airport was, in all material respects, correct.

TRAVELEX CHARGED EXCESSIVE RATES ON FOREIGN CURRENCY EXCHANGE TRANSACTIONS

In exchanging U.S. and foreign currency for SFO customers, Travelex used exchange rates in excess of the maximum allowable rates specified in the lease. As a result, Travelex overcharged some customers in the exchange of foreign currency. We tested \$409,355 in foreign exchange transactions for a sample of currencies over six sample days. We determined that Travelex overcharged customers \$6,037 by using excessive exchange rates, or an average of \$1,006 per day.

The lease specifies the maximum exchange rates at which Travelex is allowed to buy and sell foreign currencies from customers at SFO. For example, the lease specifies that Travelex may charge no more than 8.5 percent over the exchange rate posted by the New York Federal Reserve Bank for the Euro. On May 29, 2002, the posted rate for the Euro was \$0.93. Thus, Travelex could charge customers a maximum of 8.5 percent of \$0.93, or \$0.08, for a total of \$1.01 for each Euro it sold.

To determine whether Travelex charged the correct exchange rates, we calculated the rates that Travelex charged for the total of the buy transactions and the total of the sell transactions for a sample of currencies on sample days. We reviewed 10 currencies on 3 sample days in November 2001 and 11 currencies on 3 sample days in May 2002, for a total of 63 sets of currency transactions reviewed. We calculated that Travelex charged rates in excess of

those rates allowed by the lease on each of the six sample days we tested on either the buy or sell transactions for 53 of the 63 sets of currency transactions reviewed. We also found that in the 10 sets of currency transactions in which Travelex did not charge excessive rates, 2 currency transaction sets had no transactions for the day. Thus, Travelex charged appropriate rates for only 8 of the 63 sets of currency transactions reviewed.

We calculated that Travelex overcharged customers \$6,037 (1.47 percent) for the \$409,355 in transactions we tested. If Travelex made similar errors as it did on the sample days and overcharged customers by 1 percent on each day, Travelex would have overcharged customers by \$295,341 for the year.

By charging excessive exchange rates, Travelex violated the terms of its lease and may be subject to a fine of \$500 per violation per day. Further, because of its violations, the City may require Travelex to reimburse the City for the costs of an audit that shows Travelex did not comply with its lease requirements.

RECOMMENDATIONS

The Airport should take the following actions:

- Require Travelex to charge exchange rates in compliance with the lease terms.
- Determine whether Travelex charged exchange rates in excess of the allowed rates on foreign exchange transactions for the days we did not test. For each day that Travelex charged excessive rates, the Airport may impose a \$500 fine on Travelex for violating its lease.
- Consider requiring Travelex to reimburse the City for the costs of this audit. We estimate the cost of the audit to be \$19,200, and will provide our final cost calculations at a later date.

We conducted this review according to the standards established by the Institute of Internal Auditors. We limited our review to those areas specified in the audit scope section of this report.

Staff: Ben Carlick, Audit Manager
Kathy Buckley

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RESPONSE TO THE AUDIT:



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San Francisco, CA 94102-4694
Attn: Ben Carlick Audit Manager

RESPONSE TO THE REVIEW OF TRAVELEX AMERICA, INC., FOREIGN CURRENCY EXCHANGE OPERATIONS AT THE SAN FRANCISCO INTERNATIONAL AIRPORT

The following is a response to a draft of "The Review of Travellex America, Inc. Foreign Currency Exchange Operations at the San Francisco International Airport" performed by the Office of the Controller, City and County of San Francisco. This audit, number 02022, and its recommendations were conducted by Ben Carlick, Audit Manager, and his associate, Katherine Buckley Associate Auditor. Although, for the most part, Travellex agrees with the methodology employed by Mr. Carlick and Ms. Buckley to assess Travellex's adherence to the policies and procedures set forth in its lease, Travellex does not agree with the referenced penalties stated in the draft.

We have reviewed the content of the audit draft and found the information listed in the Introduction under both the "Background" and "Scope and Methodology" sections were correct. We recommend the "Audit Results" section, specifically the sub-sections "Travellex Charged Excessive Rates on Foreign Currency Exchange Transactions" and the "Recommendations" be amended to reflect our comments.

It should be noted that Travellex has charged less than the maximum allowable rates in some instances. This demonstrates that any disparity between the actual exchange rates given to customers and those rates defined by the lease are not intended to maliciously overcharge customers but represent a fair rate of exchange based on the many variable factors associated with each currency. (Euro, Japanese yen and British pounds are the most heavily traded currencies at our San Francisco International Airport locations.)

Perhaps an explanation of the methods Travellex uses to calculate the rates of exchange, provided previously, would prove helpful. It is the policy of Travellex to offer its' customers, similar to other large retail firms, consistent pricing for products across the network. To effect this and to reduce errors inherent in local spread calculation, rates of exchange are managed centrally and distributed to each location. Spot rates are taken from up to the minute information from Reuters, Inc. (The spot values listed in the San Francisco Chronicle are the previous day's closing numbers.) Our Currency Traders



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adjust the spot rates to account for the price each currency can be bought or sold in the wholesale market (this, in effect, represents the cost of product). The cost of each product varies greatly by currency due to economic factors and risk. Minor, or less heavily traded currencies, often are more expensive than major currencies. Once the cost of product is determined, we add a margin to reflect a fair retail price for each currency and to offset our direct costs - rent, payroll, etc. Traveler regularly shops its' key competitors to ensure that the margin remains in line with current market conditions. Due to the difficulties associated with using spot rates as a basis for determining price, most Airport contracts do not specifically define either the spread percentage or the source of base (spot) rates, and have moved their pricing controls to specify that rates should be in line with other similar-size international airports within North America. We respectfully request SFO similarly adjust this lease clause.

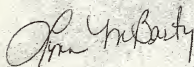
We do not believe that the \$500 fine for each daily violation nor reimbursement of audit costs should be instituted. It is not the policy of Traveler either to overcharge its customers or to violate the terms of any contract. Traveler experiences substantial financial losses at SFO. Traveler has consistently demonstrated a willingness to work through issues with SFO and we have been proactive in attempts to increase business at the airport in an environment of declining passenger numbers. We ask for support from the Airport to amend our contract to reflect the issues raised in this response.

Lastly, we would like to commend Mr. Carlick and Ms. Buckley for their professionalism, the time they devoted for a complete review and the meticulousness of their audit.

If you have any questions, please feel free to contact me using any of the following means:

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